DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

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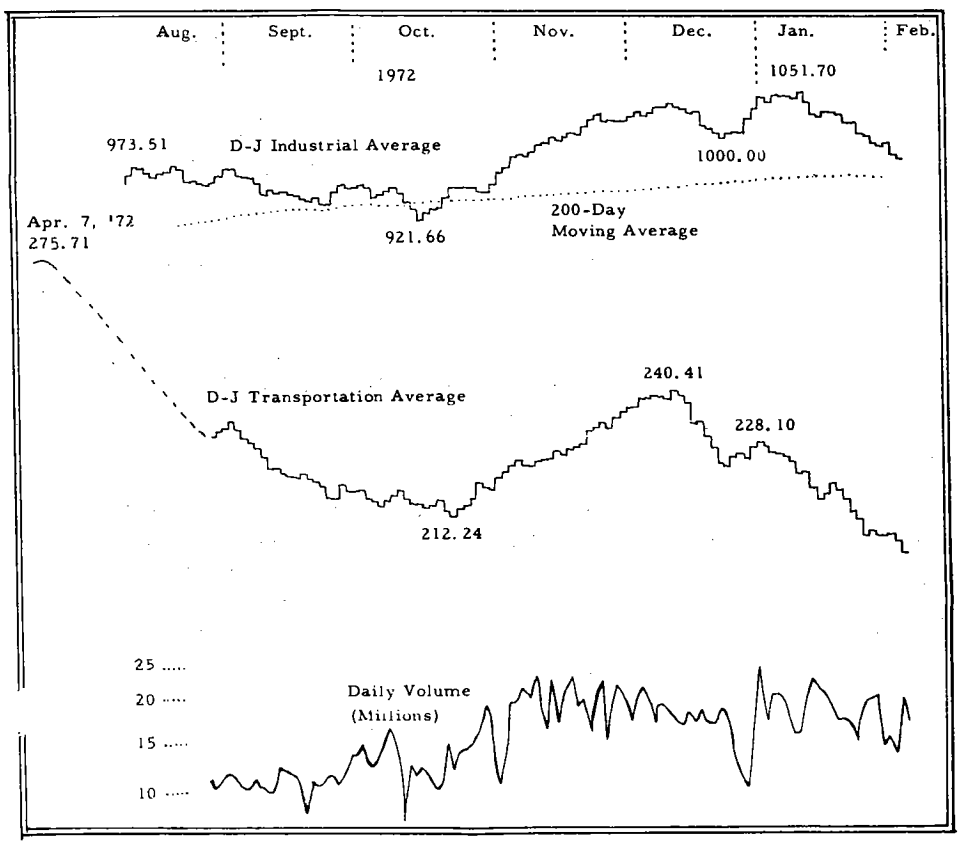
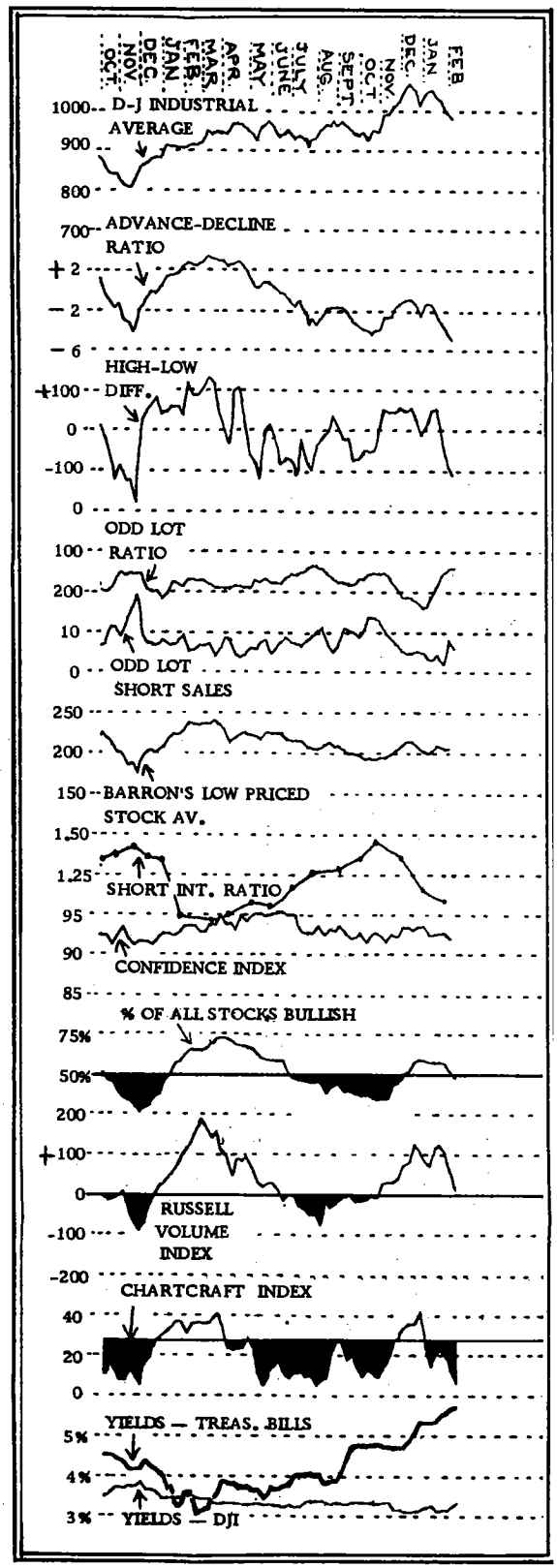
Feb. 2, DJIA 980.81, PTI 961, A-D ratio -5.21
Jan. 24, DJIA 1003.54, PTI 996, A-D ratio -3.98

THE PICTURE: Since everyone in America eats, it may be said that food prices are a very "democratic" measure of inflation; more democratic, for instance, than the market price of IBM. Last week it was announced that farm prices jumped a disgraceful 5% between mid-December and mid-January, and that farm prices were up an unbelievable 21% above a year ago. I have stated many times in these reports that monetary inflation and Government manipulation of the markets may be likened to putting a dope addict on the heroin path. Within a short time the addict "feels fine." Actually, however, his body will be gradually falling apart and he'll be getting progressively sicker. Yet he never knows how sick he is until he lands in the hospital or over-doses in some dark alley.

To transfer that picture over to the Wall Street arena is really not too difficult. For here we are just a few weeks from the 1051.70 all-time high on the Dow and the stock market is sick, daily new lows have been running near and over 100 per day, and the "grand illusion" of a primary bull market really isn't working anymore. The fact is that the public wants "out" of this market in the worst way, the mutual funds are low on cash again, the pension funds are loaded and will probably be showing losses on their massive stock purchases of the past few years, and the foreigners (who have been buying alot of US stocks) will be running for the hills if the dollar continues to sink.

My market diary has made dismal reading so far in 1973, as subscribers must have suspected. January closed with a loss of 32 points in the Dow, a loss of 21 points for Transports, and a loss of 7 points for Utilities. There is a theory





that January sets the direction for the coming year. If so, 1973 is not going to be anything like the bullish juggernaut that the prophets ("1200 on the Dow") in the January 8 issue of Barron's predict. At any rate, here is what my diary has been saying:

January 19: The D-J Transportation Average (see page 1 chart) breaks 212.24, thereby sinking to its lowest level since August, 1971.

January 22: Primary Trend Index (PTI) breaks its December, 1972 low, and heads down with a vengeance (see last Letter).

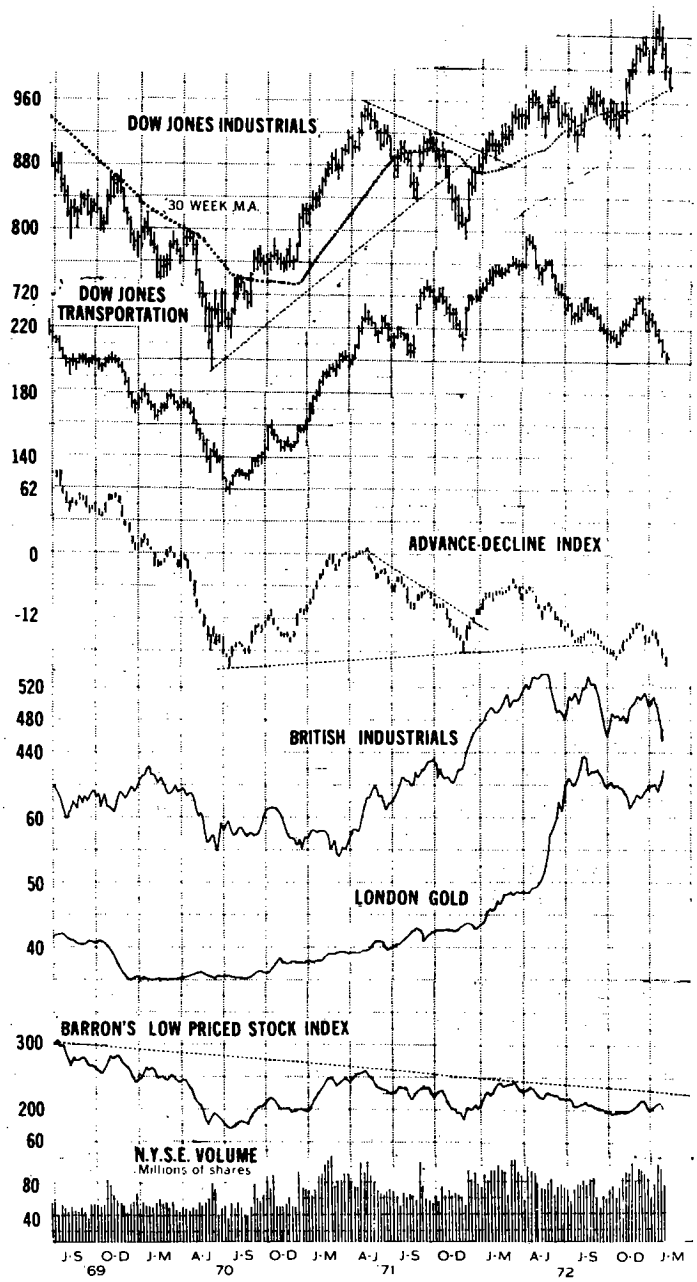
January 29: D-J Industrials crack their own December low, sinking under the 1000 level for the first time since mid-November.

February 1: Dow drops through 990 as A-D ratio smashes under its 1972 and 1971 lows to the lowest level since the 1970 crash bottom!

To further illustrate the ominous current market picture, I have included a montage of indices which I put together from the excellent weekly charts published by Comparative Market Indicators, PO Box 1557, Bellevue, WA 98009.

The top two indices are self-explanatory (the DJI and the Transports). Note the extraordinary "head-and-shoulders" top in the Transports. Also note the extreme divergence in these two Averages which has occurred since April, 1972. Such divergence as noted many times, spells danger.

The A-D ratio has been making a series of descending tops with the latest feeble peak appearing in December, 1972. This is the single indicator which has consistently given the lie to the entire "new bull market" thesis. On February 1, as mentioned in the "diary," the A-D ratio continued its incredible show of weakness by breaking through all bottoms this side of the July, 1970, primary bear market low.



The collapse of the A-D ratio is merely documenting what we already know, namely, that the majority of stocks are acting poorly, with many of them at or near their lows of the past few years. Ironically, many of the bullish services have been providing buy advice on the secondary issues as they "prepare their followers for the ultimate bull market blowoff." Those who have taken that advice have little but losses to show for their "faith."

At the bottom of the chart we see the Low-Priced Stock Index, a gauge of speculative interest in the "cats-and-dogs." The fact is that that kind of speculative interest has been absent from this market (you had to buy Sears or DuPont), and this is typical of every post-crash period. Following the collapse of 1969-70, the public only wanted its money back, which is a far cry from desiring to speculate in low-priced issues.

Meanwhile, the British market has been unraveling at the seams, as seen by the profile of the British Industrials. Britain often forms market tops before we do. Britain's entrance into the Common Market may be salutory, but it may also mean the beginning of reality for the inflation-minded little island. Finally, the London gold price winds up the series of indicators. At present, the gold bullion price seems to be flirting with the idea of pushing to an all-time high (above $70), and if this occurs it should come as no shock to readers of these Letters. So that's the story — or as much of the market story as I could get on a single chart.

MONETARY WARNINGS: I warned late last year that my monetary-market indicators were beginning to flash warning signals and that this meant tightening money, higher margin requirements for stocks, lower bond prices and lower stock prices. Last week for the first time since 1971 all four of my monetary indices moved to the bearish side.

The accompanying chart shows what is occurring. The first danger signal is given when the D-J Utility and the D-J 40 Bond Averages turn down together. Experience shows that these two indices, Utilities and Bonds, are extremely sensitive to forthcoming change in money rates, and when both indices decline "in gear" it is almost always in reflection of tightening interest rates.

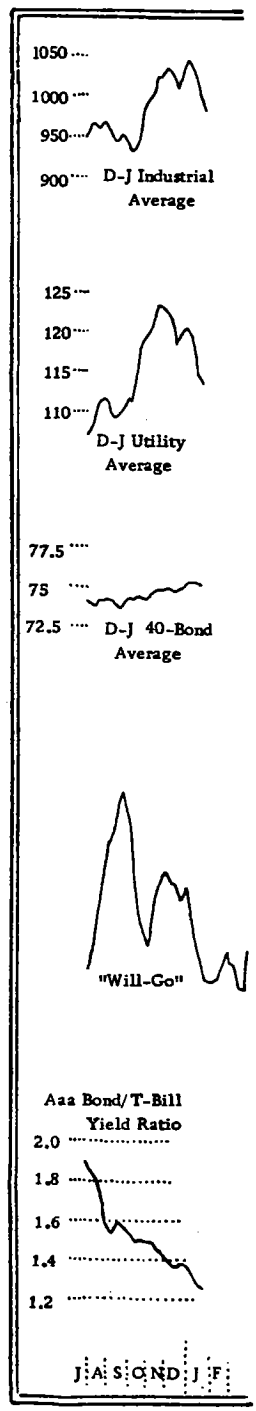
One of the early warning signals which I watch for is two consecutive weeks when both Utilities and Bonds are down. The last time this occurred were the weeks of September 6 and 13. That two-week decline was immediately followed by an advance which cancelled out the potential weakness. On January 17 Utilities and Bonds both declined, followed by a second joint decline on January 24. Last week a third consecutive decline made it a dangerous three in a row. Thus, I now rate the Utility-Bond indices bearish.

"Will-Go" has been reviewed before and is the third monetary index which I follow. Will-Go is so named because it shows with accuracy the direction the D-J Industrials will go. The basic unit of Will-Go appears in Barron's each week, and it is the yield spread between the 10-High Grade Bonds and the DJI. When this figure is compared with the figure of five weeks before, the differential is tabulated and then added to a cumulative total. The total is plotted 10 weeks ahead of the Dow. That is what you see on the chart. Will-Go shows direction, not amplitude. At present the direction Will-Go is pointing is down. Although there should be a rally (according to Will-Go) during February, and then it is down for the market in March again.

Finally, I have shown the ratio of the yields on Aaa Industrial Bonds (S & P statistics) and the 91-day US Treasury bills. When this ratio breaks 1.40, as it did in December, 1972, we have our first warning signal. The severe warning or sell signal comes when this ratio declines and breaks 1.20. On January 24, with 91-day bill yields at 5.66% and Aaa Industrial Bond yields at 7.11%, the ratio fell to a dangerous 1.26, a hair from the critical 1.20 level.

INFLATION: Much is being made of the fact that since the 1970 lows, the only "inflation" in the stock market has been seen in some of the D-J Industrial stocks and a selected number of growth issues. That, insist a majority of analysts, is proof that the big market boom in general shares has yet to come. To which I say, "It ain't necessarily so." Actually, the public was horribly burnt during 1969-70, and during the time since, the public has been doubly frustrated by the refusal of their shares to climb with the popular averages.

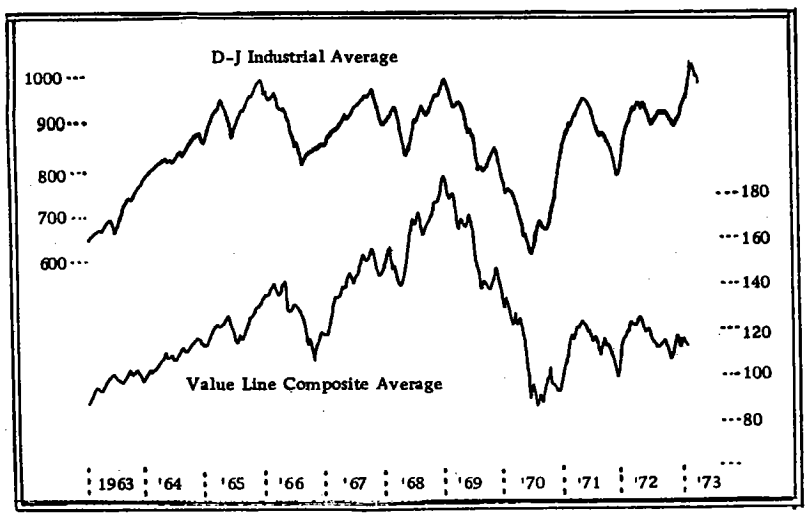
The result: The public has speculated in a thousand other areas from Arizona desert land to privately minted "coins" to vintage comic books. One of my readers, H.E. Menker of Palo Alto, has sent me a rather fascinating list which he has compiled for the year 1972, and I found this so interesting that I am including it below. It will give readers some idea of the hopes, dreams and nightmares of the speculator during 1972.



STOCK, INVESTMENT, INDEX, AVERAGE	% Change 1972
Best Franz Pick Collector's Item (numismatic coins)	UP 225%
Children's Favorite Stock (Walt Disney)	72.2
Best Arthur Lipper Mutual Fund	68.4
Best Barron's Industry Group (motion pictures)	64.0
Second Best Barron's Industry Group (farm equipment)	58.5
Best DJIA Stock (Eastman Kodak)	52.6
Gold Bars, free market	42
Barron's Gold Stock Group	36.0
Dow Jones Spot Commodities Index	31.3
Dow Jones Commodity Futures Index	26.2
Median 24 Classes Franz Pick Collector's Items (world autions of coins, stamps, wine, gems, art, antiques, books, furniture, tapestries, etc.)	25
Institutional Favorite Stock (IBM)	19.5
Most Active NYSE Stock (AT&T)	17.9
NASDAQ Over-The-Counter Composite Index	17.2
Standard & Poor Composite Index (500)	15.6
Dow Jones Industrial Average	14.6

STOCK, INVESTMENT, INDEX, AVERAGE		% Change 1972
New York Stock Exchange Composite Index		14.3
Barron's 32-Industry Group Total		13.8
Average Arthur Lipper Mutual Fund		9.3
Listed Shares Traded (NYSE plus ASE)		5.9
Savings & Loan Account		5
American Stock Exchange Price Change Index		3.0
Dow Jones 40-Bond Average		2.3
Dow Jones Utility Average		1.5
Value Line Composite Average (1400)		1
General Motors Corp.		0.8
Barron's 20 Low-Priced Stock Average	DOWN	3.1
Dow Jones Transportation Average		-6.8
U.S. Dollar (Franz Pick World Market)		-7
Second Worst Barron's Industry Group (rubber)		-20.2
Worst DJIA Stock (Woolworth)		-30.7
Average Price of Common Stock of 5 Leading Broker/Dealers (Merrill, Lynch; First Boston; Bache, Weeden, Hayden Stone)		-34.0
Worst Arthur Lipper Mutual Fund		-34
Worst Barron's Industry Group (air transport)		-36.5
Tenth Most Active NYSE Stock (Pan Amer. World Air.)		-41.0
Worst Franz Pick Collector's Item (paperweights)	Below	-40

For a real perspective on the plight of the average investor, I am again including a chart of the Value Line Composite Average. This is a geometric average which means that each of the 1175 common stocks on the NYSE which it covers are given equal weight in terms of percentage of movement. The Value Line Average gives a very good representation of what has happened to the average investor's portfolio. Remember, the average investor does not own five or six Dow Industrial stocks, he owns five or six sundry "stocks" of the kind represented in Value Line's Average. And this is why he is in bad shape today, why he is selling out his odd lots, why he is redeeming his mutual funds.



I have superimposed the pattern of the D-J Industrial Average upon the Value Line Composite, and the comparison is quite dramatic. For the fact is that on an unweighted basis, the average stock on the NYSE dropped 54% from the 1968 peak to the 1970 low. And on the basis of the Value Line Average, we can see that the average NYSE issue has only gained about 15% (!) of its losses, this while a selected number of Dow Industrial stocks had been strong enough to take the weighted DJIA to record highs above 1000.

Most people do not realize that the Dow Average is weighted for the price of each stock in the Average (S & P is weighted for capitalization). Thus three stocks in the Dow, DuPont, Sears and Kodak (because of their high price) account for 25% of the Dow. IBM (because of its huge capitalization which is equal to GM and Telephone together) is worth about 2.5% of the S & P Average. In fact, the market value of IBM is now equal to the total value of all the stocks listed on the Amex. How is that for a study in P/E ratios and market value!

Now, do not think that I am downing the Dow as a market indicator, as a standard from which all divergent studies are taken. I am not. The Dow is still one of the most useful, sensitive and important indicators available, and the one which is followed around the world.

GOLD: There's a remarkable article sandwiched inbetween the pages of the January 26 Economist, the famous British magazine. The article under the innocent title "Money," makes a number of statements, which I am listing on page 5. Following those statements I am including my own translations.

(1) Luxemburg — "Senior finance officials of the Nine startled themselves this week by discovering that they may be closer to agreement on a new world monetary system than they had imagined...At a private meeting of the EEC monetary committee... Mr. Kit McMahon of the Bank of England led a discussion on the place of gold in a new monetary order: This supported moves to allow central banks to abandon the 1968 gold agreement and sell or buy gold on the free market either directly or indirectly while using the IMF as an intermediary, while keeping the official price at $38 an ounce."

(2) "The Germans paused only to point out that a completely free use of central bank gold on the free market would stand to increase the book value of official reserves at the present market price by $25 billion."

(3) "This paper (the Economist) argues the case for making gold the numeraire of the new system, largely on the grounds of finding disadvantages in any alternative."

(4) "The preference of the Nine is increasingly for a multinational solution...This plan envisages convertibility of surplus dollar balances (including old balances) into prime reserve assets exclusively through the IMF (that is without putting convertibility at the mercy of another renege by the US). And it spells out further the idea that reserve currency countries should be obliged to provide the IMF with assets against their currencies presented for conversion to the IMF, at least up to the limit of their balance of payments deficits in any one year."

Translation: (1) The $38 official gold price set by the US is a pathetic joke. Europe wants its central banks to be able to buy and sell gold on the free market at the prevailing free market price. They want to use the IMF as the official instrument for pulling the US's ostrich neck out of the sand and into the world of reality as regards gold and money. If they use the IMF, no single country can be blamed by the US.

(2) If gold is freely bought and sold on the free market, all gold will obviously be worth the free market price, and this will mean the European central banks will mark up their gold reserves by about $25 billion. This is fine with Europe, which now owns most of the gold which used to belong to the US. One problem remains — how to get the remaining $10 billion dollars in gold which is still in the US!

(3) The Economist, which has been anti-gold for years, has thrown in the sponge on its anti-gold position since it sees that SDR's are a second-rate reserve and that in the end, monetary gimmicks can't take the place of gold.

(4) Europe is like a winning group of card players who have built up a giant pile of chips (dollars). They have said to the dealer, "Cash us in." The dealer (the US which is running the dollar, the reserve currency) says, "Er, I can't make it fellows, so why don't we turn this into some other kind of game?" The problem for the boys with the chips: how to get those chips without panicking the dealer.

What they want in paragraph 4 is to force the US to turn its gold into the IMF. Then, the Europeans can turn their surplus dollars into the IMF for gold. The Europeans also want the US to settle up each year by turning in gold at least to the amount of its payments deficit. One way or another, the Europeans want the remaining pile of US gold. Why shouldn't they, it's mortgaged six times over to them anyway (i.e., there are over $60 billion in overseas central banks, and all these dollars would be entitled to be exchanged for US gold, if the US only had the gold to honor its creditors).

Conclusion: Gold is playing a stronger and stronger role in the minds of the Europeans. The Europeans are seeing the folly of all forms of fiat paper money including the once highly-touted SDR's. Mr. Nixon will be hearing more and more from Europe about the unsatisfactoriness of the current US monetary stand. A European currency (gold backed) is being planned. Nixon will have to put the brakes on inflation or be prepared to find the US squeezed out of international trading. Who will play with a nation which uses chips that can never be turned in? The dollar must be made convertible or it will be increasingly unwanted. The pressure is mounting. The barometer of that pressure will continue to be the price of gold.

Despite Truce, Defense Budget Tops $81 Billion

Portion for Vietnam War Will Be Redirected; Added Manpower Costs Blamed for Increases

BY RUDY ABRAMSON
Times Staff Writer

WASHINGTON—President Nixon's $81.1 billion defense budget was submitted to Congress two days after the Vietnam cease-fire, but the end of the war will have little impact on spending to maintain the na- the $79.9 billion in 1945, the last year of World War II. But defense officials said that when inflation is considered the United States is devoting less of its gross national product and its total federal budget to

BONN AIDE'S VIEW

Monetary Reform Called 'Illusory'

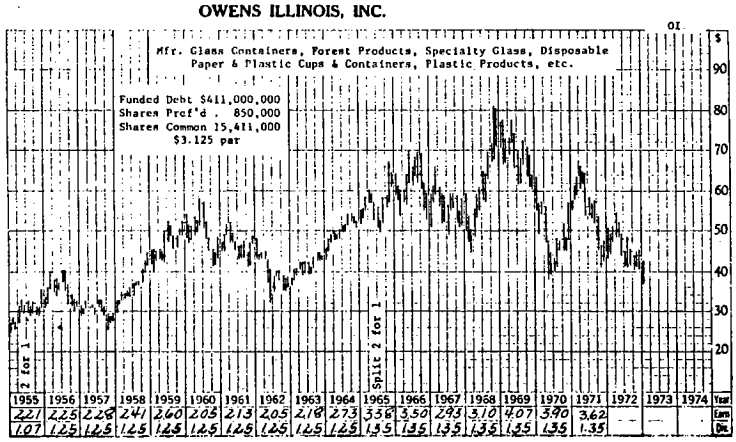
Editorial—Page B-6

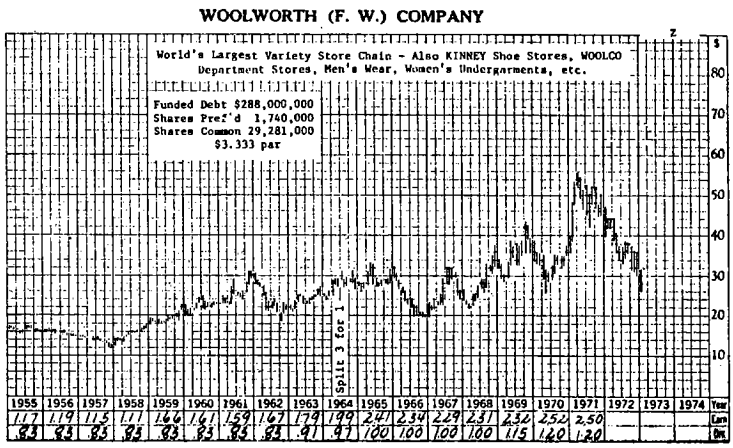
BONN, Germany (AP) — Finance Minister Helmut Schmidt said yesterday world monetary reform will remain "totally illusory" until the U.S. balance of payments deficit is corrected.

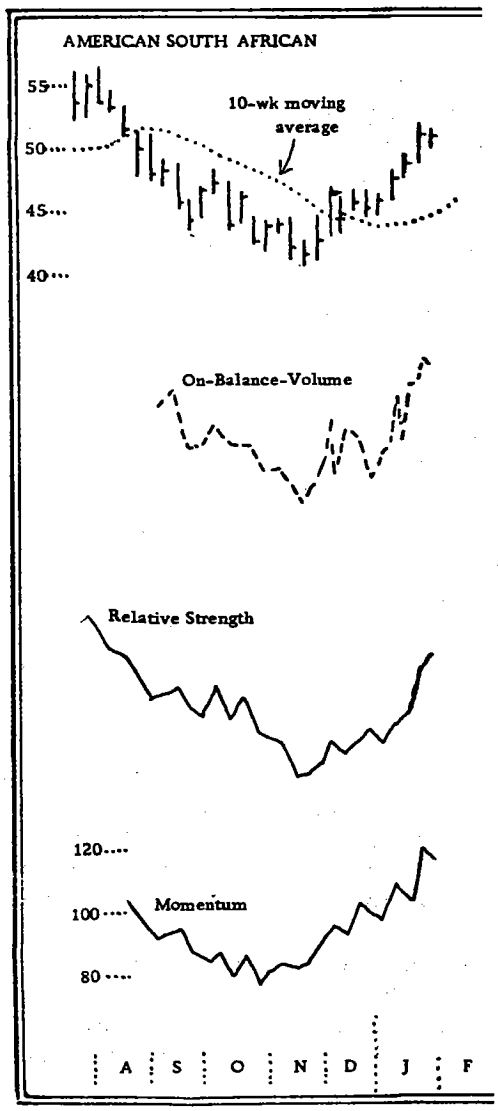
Common Market governments and their European Commission in Brussels should realize "the Americans cannot put their balance of payments to rights by themselves."

Even while the US was packing up to go home under the shield of the Vietnam truce, the news was released about the 1973 budget. And the news must have made our foreign creditors mumble under their breath. One who did not mumble (see news clip) was Bonn Finance Minister Helmut Schmidt. In a rare burst of candor, Schmidt chastised the US for pursuing "illusory" monetary reform while it continued to run up deficits like a drunken sailor.

Meanwhile, anyone who thinks that our pullout from Vietnam is going to help the budget might cast eyes on this second news clip (page 5) which states flatly that our new defense budget will be a staggering $81 billion. Any "peace dividend" will be eaten away by "pay increases and inflation." In view of all this and in view of our reported $6.4 billion trade deficit for 1972, the price of gold on the free market jumped last week to over $66, the highest level in four months. At the same time the US dollar (despite the Fed's buying of German marks to support the dollar) fell to its lowest level in history. Nothing has changed, and it seems that whatever change does lie ahead will stem not from the politicians but from the "bloodless verdict of the market place."


OWENS ILLINOIS, INC.
Mfr. Glass Containers, Forest Products, Specialty Glass, Disposable Paper & Plastic Cups & Containers, Plastic Products, etc.
Funded Debt $411,000,000
Shares Pref'd 850,000
Shares Common 15,411,000
$3.125 par
Split 2 for 1


WOOLWORTH (F. W.) COMPANY
World's Largest Variety Store Chain - Also KINNEY Shoe Stores, WOOLCO Department Stores, Men's Wear, Women's Undergarments, etc.
Funded Debt $288,000,000
Shares Pref'd 1,740,000
Shares Common 29,281,000
$3.333 par
Split 3 for 1



STOCKS: The special technical charts of the Dow stocks which we run here show that only three Dow Industrials now carry a "strong" rating of 4, 5 or 6. These are Allied Chemical (4), Exxon (4) and Standard Oil of Calif. (4). On the other hand, sixteen Dow Industrials now carry "weak" ratings of zero or one. The zero ratings are Goodyear, Int. Harvester, Owens Illinois, Westinghouse and Woolworth.

I am including monthly charts of Owens Ill and Woolworth because the current action of these stocks is of historical interest. (Charts are courtesy of M. C. Horsey, Salisbury, MD 21801).

From a 1968 all-time high of 81, Owens has dropped into the high 30's, a collapse of major bear market proportions. Thus, the value of this giant corporation has been cut more than 50% within four years!

From a 1971 all-time high of 55 3/4, the great Woolworth chain has fallen to today's price in the mid-20's, a crushing straight-line collapse wiping out more than half of this billion dollar corporation's market value. In both cases, we see what can happen to even the greatest companies during underlying bear market conditions. The question is whether Woolworth and Owens are leading the way for the rest of the Dow stocks.

Meanwhile, the technical chart of much recommended American South African continues to appear strong with all indicators pointing up. On-balance-volume is hitting new highs ahead of price which is a bullish sign, relative strength is climbing as the rest of the market weakens. Momentum, now near 120, cannot be expected to climb much higher, but it would be a sign of strength if it moved sideways from here.